Supreme Court of the United States

OCTOBER TERM, A. D., 1933

No. 128

THE TEXAS AND PACIFIC RAILWAY COMPANY,
Appellant,

versus

S. O. POTTORFF, Receiver of The First National Bank of El Paso, Texas, *Appellee.*

REPLY BRIEF ON BEHALF OF S. O. POTTORFF, RECEIVER OF THE FIRST NATIONAL BANK OF EL PASO, TEXAS

ABSTRACT AND STATEMENT OF THE CASE

The statement of the pleadings, of the evidence and of the proceedings in the Trial Court and in the Circuit Court of Appeals as made by Appellant is sufficient to acquaint this Court with the nature of the suit and with the character of the questions which are involved.

ARGUMENT

Introduction

There are three questions involved in this appeal.

I. Did the First National Bank have the power to pledge a portion of its assets to secure the payment of the private deposits made by the Texas and Pacific Railway Company?

2. Can the receiver of the First National Bank assert the invalidity of the pledge?

3. Does any basis exist for granting the Texas and Pacific Railway Company a preferred claim against the receiver for the amount of its deposit balance?

A. THE FIRST NATIONAL BANK, UNDER THE NATIONAL BANKING LAWS AS THEY EXISTED IN JANUARY, 1931, AND THEREAFTER, HAD NO POWER TO PLEDGE THE LIBERTY BONDS INVOLVED IN THIS SUIT TO SECURE THE PAYMENT OF THE PRIVATE DEPOSITS OF THE TEXAS AND PACIFIC RAILWAY COMPANY. THE ATTEMPTED PLEDGE WAS VOID.

I. No express power has been conferred on national banks to pledge assets to guarantee the payment of private deposits.

All national banks are organized under and governed by the provisions of the laws of the United States. The corporate powers of a national bank were prescribed by Section 8 of the National Banking Act of 1864 (Act of June 3, 1864, c. 106, Stat. 101, now U. S. C. Tit. 12, Sec.

24; R. S., Sec. 5136), which provides that such a bank shall have power to adopt a seal, to have succession for ninety-nine years, to make contracts, to sue and be sued, to elect directors and officers, to prescribe by-laws and

> "Seventh. To exercise by its board of directors, or duly authorized officers or agents, subject to law, *all such incidental powers as shall be necessary to carry on the business of banking;* by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; *by receiving deposits;* by buying and selling exchange, coin and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this chapter."

It is settled that the provisions of this act as to discounting notes, receiving deposits, etc., are to be read as descriptive of the kind of banking which is authorized and as illustrative of incidental powers. *First National Bank of Charlotte v. National Exchange Bank of Baltimore,* 92 U. S. 122 (1875); *Western National Bank v. Armstrong,* 152 U. S. 346 (1894). It follows that the incidental powers granted by the act are not those incidental to receiving deposits, etc., but are those "necessary to carry on the business of banking." Thus it has been said in *Logan County National Bank v. Townsend,* 139 U. S. 67, on 73 (1891):

> "that the national banking act is an enabling act for all associations organized under it, and *that a national bank cannot rightfully exercise any powers except those expressly granted by that act, or such incidental powers as are necessary to carry on the business of banking for which it was established.*" (This statement has been quoted or referred to with approval in all subsequent cases.)

There is no express statutory provision which grants national banks the power to pledge assets as security for

private deposits; therefore, if the power exists, it must be by virtue of the incidental powers.

II. National banks do not have implied power to pledge their assets to guarantee the payment of private deposits.

In determining what powers are "necessary to carry on the business of banking," we may well adopt as a general statement the definition of Mr. Chief Justice Marshall when he said that, necessary, "imports no more than that one thing is convenient, or useful, or essential to another."[1] But, this quotation must be taken along with the more directly appropriate language of Mr. Chief Justice Waite, who, after quoting paragraph seventh of the National Banking Act of June 3, 1864, which reads as follows:

> "Seventh. To exercise by its Board of Directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this Chapter;"

said:

> "Authority is thus given to transact such a banking business as is specified, and all incidental powers necessary to carry it on are granted. These powers are such as are required to meet all the legitimate demands of the authorized business, and to enable

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1 McCullough v. Maryland, 4 Wheaton 216, 412; 4 Law Ed. 579, 603.

the bank to conduct its affairs within the general scope of its charter, *safely and prudently.*"[2]

We should also take direction from the language in *Thomas v. West Jersey Railroad Company*, 101 U. S. 71; 25 Law Ed. 950. Mr. Justice Miller said:

> "That principle is, that where a corporation, like a railroad company, has granted to it by charter a franchise intended in large measure to be exercised for the public good, the due performance of the functions being the consideration of the public grant, any contract which disables the corporation from performing those functions which undertakes, without the consent of the state, to transfer to others the rights and powers conferred by the charter, and to relieve the grantees of the burden which it imposes, is a violation of the contract with the state, and is void as against public policy."

It is true that in the cited case the corporation had sought by a lease to deprive itself of performing its duties to the public. But the reasoning is sufficient to justify us in saying that a power, which, if exercised by a bank, would be calculated to disable and prevent a bank from performing its important duties to the public, should not be considered necessary. An act which is not authorized by the express terms of a statute, and which is calculated to render a bank unsafe and incapable of performing its proper functions, is against public policy.

Some of the opinions which we shall cite hold that the securing of private deposits by the pledging of bank assets is void because against public policy. We say that such an act, if it is destructive of sound banking, is not useful or essential, is not necessary, and is therefore not within the authority conferred by implication.

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2 First National Bank of Charlotte v. National Exchange Bank, 92 U. S. 122; 23 Law Ed. 679, 681 (1875).

(a) THE PLEDGING BY BANKS OF THEIR ASSETS TO SECURE PRIVATE DEPOSITS IS NOT HELPFUL IN OBTAINING AND RETAINING PRIVATE DEPOSITS AND IN RENDERING THE TRANSACTION OF THE BANKING BUSINESS SAFE AND PROFITABLE.

National banks have become charged with a public interest. They are carefully regulated by statute and by numerous safeguarding regulations of the Treasury Department, administered by the Comptroller of the Currency. It is a far cry from the private banker of old England to the modern institution of today. Banks in these days must publish at stated intervals reports which show the nature of their assets and liabilities.

As they are now prepared, these reports make no mention of pledges which may have been made to secure individual private deposits. The public is led to believe that all of the particular bank's assets, except such as may, in accordance with law, secure public deposits, stand as security for the payment of all private deposits, without preference, and upon the strictest equality. If present publication regulations are continued, and pledges are made to secure private deposits, such pledges will be made in secret so far as the public is concerned. The result is the perpetration of the grossest fraud on the unsecured creditors of the bank.

Opposing counsel may reply by adopting the views expressed in the dissenting opinion of Circuit Judge Alschuler in *Sneeden v. City of Marion*, 64 Fed. (2d) 721, 731. He said:

> "It is pointed out, in support of such a public policy of the state, that ordinarily there is secrecy in such pledges of which the general public has no notice, and that depositors not so secured would usually have no means of knowing how much of the bank's reported assets are so segregated.

"It seems to me that the vice is not with the pledging of the assets, but with the laws and regulations concerning reports and advertisements of banks. I fully agree that banks should be required to make frequent public reports of their condition, and that in such reports it should be specifically disclosed what part of the reported assets is so pledged. To my mind it is a vicious practice to permit banks to advertise their 'resources' at an amount inclusive of their total deposits, without requiring that at the same time, and quite as prominently, there be stated the liabilities to which the resources are subject."

But suppose a bank should be required to publish the nature and extent of its pledges of assets to secure private deposits. No bank, in good times, and with its own affairs in excellent condition, would care to invite the practice by publishing notice that some of its private depositors had demanded and obtained securities. If times were hard, and if the bank were anxious to retain its larger depositors, and if the practice were generally recognized as legal, the bank would, in certain instances, be required to make pledges of its assets. The publication of its next statement would advise the public of what had taken place. The demand for security would become general. The ultimate effect would be ruinous to the bank and disastrous to unsecured and partially secured creditors.

Another specious argument is frequently made. It is said that the bank and its creditors are not injured by the pledging of its assets, that the bank receives in cash the same amount as the amount of the debt for which the bank's assets are pledged. It is said that upon the return of the money the pledged assets are released. Let us examine into this claim. Of course, if the pledged assets consist of Liberty Bonds, and if they have at all times a ready sale at par, the argument might seem to be of some

merit. But if the power to pledge exists, a bank may pledge any character of asset, and the pledge agreement may contain the strict provisions usually found in such instruments. It is easily conceivable that when the practice becomes recognized and general, a bank might be required to pledge the personal notes of its customers of $150,000.00 to secure a demand deposit of $100,000.00. The pledge agreement might provide for sale on ten days' notice. Suppose a number of such instances. It is not hard to picture the plight of the unsecured creditors in the event of insolvency.

Circuit Judge Alschuler, in his dissenting opinion in *Sneeden v. City of Marion*, supra, says:

> "It is also pointed out that such pledging of a bank's assets may in case of the bank's threatened disaster, enable certain depositors to be favored as against others. This, of course, would bring into the picture collusion and probably fraud, which would be dealt with when it appears. . . . ."

The learned judge does not take into account the fact that the effect of non-fraudulent and perfectly valid pledges would be as vicious and as disastrous in result to unsecured creditors as those made with knowledge of insolvency. Neither does he consider the practical difficulty involved in proving actual fraud and knowledge of insolvency.

We here mention the results to unsecured creditors of allowing a bank to pledge its assets to secure private deposits for the reason that the public will not be unmindful of the danger. With such knowledge, no depositor would be so careless of his own interest as to remain quiescent while his fellows were demanding and receiving security. Moreover, no man will for long continue to do his banking business with an institution where

he must constantly watch the value of the collateral securing his deposit.

When we turn to the other side of the picture, we see that no bank can do a profitable business if a substantial portion of its assets are frozen in pledges.

That the practice under examination is neither necessary nor helpful is made evident by the fact that during the long history of national banking in this country no case directly raising the question of the validity of such pledges has heretofore arisen to be decided by this Court, and no such question was directly presented in the Federal Courts prior to the case of *Smith against Baltimore and Ohio Railroad Company,* decided in the District Court, Western District of Pennsylvania, March 5, 1931. It might be said that for a long period no case arose in the Federal Courts involving the validity of a pledge of assets to secure public deposits. This is of little significance, because the Comptroller always recognised such pledges as valid. His receivers, acting under his instructions, did not question their validity, and there was therefore no opportunity of raising the question in the Federal Courts prior to the enactment of the Amendment of June 25, 1930.

The testimony of Appellant's witness, J. E. Benton, is significant on the question of the necessity for this practice. He testified in part as follows:

> "My name is J. E. Benton. I was formerly vice-President and Cashier of the First National Bank here in El Paso. I was connected with that Bank since February, 1903." (P. 63, R.)

He also testified:

> "The bank furnished surety company bonds to secure deposits. We guaranteed deposits by surety bonds. I would imagine that the bank had between

6,000 and 7,000 depositors. Out of those 6,000 or 7,000 deposits there were maybe six or eight or ten deposits secured by a surety bond at any one time, excluding the Government, and such accounts as that. It was the custom of the bank to give security to a few of the corporations, six or eight or ten. I think that a great many of the corporations insisted on it, and some paid the premiums themselves, and others we paid the premiums on, but those that paid the premiums would exceed that six or eight or ten I mentioned. Those instruments were in the form of surety bonds. It was not a pledge of the assets of the bank. *As far as I can remember this is the only case where a private account was secured by pledging the assets.*" (Page 74, R).

And, it must be borne in mind that this instance did not take place until the heavy withdrawals, which closed the bank, had begun.

This is a strong indication that such a practice was not necessary to the conduct of the banking business. Moreover, whenever it becomes known that certain private depositors of a bank are insisting upon, and obtaining, a pledge of the bank's assets to secure payment of their deposits, other depositors are led to demand similar security. If the practice continues, it eventually ties up the assets of the bank, and destroys the bank's usefulness.

The primary functions of a bank are to accumulate and to lend money. If each depositor insists upon his deposit being guaranteed by the pledge of collateral, the bank's ability to lend, and thereby earn a profit, is seriously impaired. By such a practice, public confidence in the integrity of the bank is destroyed, and its usefulness ends.

Moreover, if such practice is allowed, the large and alert depositors are protected, and, in event of insolvency, the small unsecured depositors are discriminated against.

If such practice is allowed, public bank statements showing assets available for the protection of depositors become a deceit and a fraud. Certainly, any practice which cannot stand publicity and which impairs and ultimately destroys the bank's usefulness, cannot be a necessary incident to the business of banking.

(b) THE RULINGS AND PRACTICE OF THE UNITED STATES TREASURY DEPARTMENT INDICATE THAT THE PLEDGING OF SECURITIES TO GUARANTEE PRIVATE DEPOSITS IS NOT NECESSARY TO THE BUSINESS OF BANKING.

Appellant's contention is that it is necessary for banks, in order to carry on their business, to give security for private deposits. Appellant then says that because of this assumed necessity, an implied power exists in banks to give such security. The conclusion is wrong, because the premise is unsound. Certainly, the Treasury Department, and more particularly the Comptroller, is qualified to judge of the necessity for the exercises of such a power by national banks. The Comptroller has consistently maintained the position that national banks have no such power. Attached as an Appendix are copies of letters showing the Comptroller's attitude.

In the case of *Baltimore and Ohio Railroad Company v. Smith, Receiver,* 56 Fed. (2d) 799, the Circuit Court of Appeals of the Third Circuit rendered an opinion fully supporting our contention in this case. In that opinion it was stated:

> "There is no evidence showing that it is necessary. On the other hand, inference is fairly reasonable that thousands of successful banks have never exercised such power. It cannot be concluded from the evidence that the exercise of such power is necessary in order to carry on the business of banking successfully. It is admitted that whenever the Comptroller was asked for an opinion as to the

power of national banks to pledge collateral to secure private deposits, in every instance, he has disapproved of such pledges and held that, in his opinion, national banks do not have that power. Such uniform and long continued interpretation and practice of an act by the Department charged with administering it has great weight, and is persuasive as to its correct construction."

And, in the Agreed Statement of Facts in that case it is said:

> "However, during, before and after the said period of February 23, 1928, to July 31, 1930, when the said Comptroller was requested by national banks or others for an opinion upon the power of national banks to pledge securities to secure a private depositor, in every instance the Comptroller disapproved of such pledging by stating that, in his opinion, national banks had no such power."

The Comptroller of the Currency is charged with visitorial duties over national banks; he is charged with the execution, administration, and application of the banking laws. Therefore, his construction or interpretation of the banking laws is entitled to great weight.

The attitude of the Treasury Department was shown when the Act of June 25, 1930, amending Section 45 (R. S. 5153) of the National Banking Act was passed. The acting Secretary of the Treasury wrote to the Committee which had the bill under consideration as follows:

> "While the office of the Comptroller of the Currency has consistently taken the position that national banks have the right to give security for the safekeeping and prompt payment of public monies of the state or other political subdivisions thereof, deposited with such national banking associations, several recent decisions have thrown some doubt on this question, with the result that in some states the

state banks may secure the public deposits, but the officers of the state are in doubt about depositing with the national banks in the absence of any specific law by Congress on the subject. It would be extremely helpful, therefore, if it is possible for your Committee to report out, and the House pass, S. 486."

The Supreme Court has this to say with reference to the interpretation by an executive department of a law of Congress:[3]

> "Even if the meaning were not otherwise made plain, we should be slow to reject the construction thus put on the section by the head of the Department charged with administering it."

And again:[4]

> "So, even if there was some uncertainty in the Act, we should regard this long continued and uniform practice of the officers charged with the duty of administering it as persuasively determinative of its construction."

So, in our case, the administrative official charged with enforcing the banking laws of the United States has denied to national banks the power to pledge assets as security for private deposits. Because of *dicta* in some Court decisions casting doubt upon the power of national banks to protect public deposits, the amendment of 1930 was passed.

The failure of Congress to say anything with reference to private deposits adds very materially to the weight

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3 Kern River Co. v. U. S., 257 U. S. 147 on 154 (1921); other authorities to the same effect are Corsicana National Bank v. Johnson, 251 U. S. 68 on 83 (1919); First National Bank in St. Louis v. State of Missouri, 263 U. S. 640 on 652 (1925); 25 R. C. L. 1043, Section 274.

4 U. S. v. Minnesota, 270 U. S. 181, on 205 (1926).

to be given to the Comptroller's interpretation with reference to securing private deposits, and would seem to amount to a distinct recognition by Congress of the correctness of the Comptroller's view. The long continued construction put upon the national banking act by the Comptroller, concurred in by Congress, is conclusive that the power to pledge assets to protect a private deposit does not exist.

But, it is said that in this case the Comptroller, acting through his examiners, had notice on August 6, 1931, that the Liberty Bonds involved in this suit had been pledged to secure the private deposit of The Texas and Pacific Railway Company, and that the Comptroller made no objection to such pledge. The testimony on this point was given by S. O. Pottorff. He testified:

> "I am the Receiver of the First National Bank here in El Paso. There were no examinations made by the bank examiners of the condition of the bank from the 29th day of January, 1931, until August 6, 1931. There was one examination made between the 29th of January, 1931, and September 6, 1931. That examination began at eight o'clock in the morning, August 6th, and ended at noon on August 20th. The examiner was Jacob Embry. I don't know the names of his assistants. I think Mr. Collier was here in charge, although I was not here." (Page 82, R.)

This witness also testified:

> "This report of the examination made in August, 1931, was not sent in to the Comptroller of the Currency until after the Bank had closed. I know that of my own knowledge." (Page 87, R.)

It is thus apparent that neither the Comptroller nor any of his examiners knew of this pledge until shortly before the Bank was closed, and that the Comptroller was never called upon to pass on the validity of this pledge.

(c) CONGRESS, BY PASSING THE ACT OF JUNE 25, 1930, SECTION 45 (R. S. 5153), MADE IT CLEAR THAT NATIONAL BANKS SHOULD THEREAFTER HAVE NO POWER TO PLEDGE THEIR ASSETS TO SECURE PRIVATE DEPOSITS.

We find the following statement in the brief filed on behalf of Illinois Central Railroad Company as Amicus Curiae in connection with the application for Writ of Certiorari in this case:

> "The statement of this amendment is not that security shall be given, but security *may* be given and it is therefore contended by the Receiver that as the act only grants authority to give security for the public moneys of a state or political subdivision thereof, therefore, it was the plain intention of Congress to withhold the power to give security for a private deposit. This is a plain *non sequitur* for the following reasons: In the first place, it was known that national banks did give security to private depositors and if Congress had intended to stop such practice it would have been prohibited by express enactment; second, the history of the passage of this Act of 1930 shows that it was passed merely to quiet doubts of some timid national bankers and to confirm in direct and positive statutory form a power (though already existing) to national banks so that they could compete with state banks, which were obtaining state deposits by giving security therefor."

We find the following statement in the brief filed on behalf of the Texas and Pacific Railway Company:

> "It thus appears that Congress, by amending section 90 of the National Bank Act to afford the specific relief sought, had no intention to and in fact did not define, amend or restrict any power granted to national banks by section 24 of that Act."

The report of the Senate Committee was based on a letter from the Attorney General of Minnesota which contained the following language:

> ". . . . The national banks of this State have pledged with the State and the various subdivisions thereof millions of dollars in Government and other bonds as security for public deposits. They are anxious to be permitted to do so, and we are willing that they should. Under the law as it now stands we may be taking a chance in accepting such pledges from the national banks, and we should like to have the chance removed by legislation in Congress which will specifically authorize such pledges by national Banks."

The House Committee had received a request from the Acting Secretary of the Treasury reading in part as follows:

> "While the office of the Comptroller of the Currency has consistently taken the position that national banks have the right to give security for the safe-keeping and prompt payment of public moneys of the State or political subdivision thereof deposited with such national banking associations, several recent decisions have thrown some doubt on this question with the result that in some States the State banks may secure the public deposits, but the officers of the State are in doubt about depositing with the national banks in the absence of any specific law by Congress on the subject. It would be extremely helpful therefore, if it is possible for your committee to report out, and the House pass, S. 486."

Counsel for the Illinois Central Railroad Company say:

"In the first place, it was known that national banks could give security to private depositors, and if Congress had intended to stop such practice, it would have been prohibited by express enactment."

There is nothing to indicate that Congress knew that banks were giving security for private deposits. On the contrary, Congress knew that the banks had seldom sought to guarantee private deposits, and knew that the Comptroller had consistently ruled that no such authority existed. The banking fraternity also knew this to be a fact. It was also known that the great weight of modern authority was to effect that banks did not have the right to pledge assets to secure private deposits. If Congress had intended that national banks should have unrestricted authority to pledge assets to guarantee all deposits, both public and private, it would have been a simple matter to have adopted an act reading:

"National banks shall have authority to pledge their assets to secure the payment of deposits."

This would have been broad enough to have given national banks every authority held by state banks, and would have left intact any supposed additional authority in national banks to guarantee generally both public and private deposits. Congress, however, was unwilling to go that far. It was not even willing to grant general authority to pledge assets to secure public deposits. It gave to national banks the right to pledge assets to secure public deposits, with the limitation that such security should be "of the same kind as is authorized by the law of the state in which such association is located in the case of other banking institutions in the state."

The doctrine of "expressio unius est exclusio alterius"

is applicable here.[5] Moreover, the language in *State ex rel. v. First National Bank*, 249 S. W. 619 (Missouri—1923), affirmed in *First National Bank v. Missouri*, 263 U. S. 640 (1924), reading:

> "Despite this fact where, as here, there is a general grant of power, however clear that grant may be, the enactment of subsequent legislation containing a specific kindred grant of power will afford at least persuasive support to the conclusion that the latter was not included within the former or the original grant. Such is the effect of the Act of Congress of March 3, 1865, Section 5155, 3 U. S. Comp. Stats. 1901, p. 3467, now U. S. Comp. St. Section 9695. This Act provides that any bank or banking institution organized under a state law and having branches, may in conformity with existing law become a national bank and retain its branches. In the passage of this act it is evident that the legislative construction of the original is that it did not authorize the establishment of branch banks. Otherwise, the subsequent Section 5155 would not have been enacted."

is in point.

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5 25 R. C. L., Section 229, page 981: " 'Expressio unius est exclusio alterius' is a universal maxim in the construction of statutes"; U. S. v. Arredondo, 8 Law Ed. 547, 560, 6 Peters 691; "If Congress had intended to exempt any other articles of growth or production of those countries, the articles would have been enumerated and included in that exception, 'expressio unius est exclusio alterius'," Sturges vs. Draper, 20 Law Ed. 255, 258, 12 Wallace 19; "Thus enumeration of the purposes for which the corporation could acquire title to real estate must necessarily be held exclusive of all other purposes," Case vs. Kelly, 33 Law Ed. 513, 515, 133 U. S. 21; "But when we consider the general rule that the affirmative description of the cases in which the jurisdiction may be exercised implies a negative on the exercise of such power in other cases . . . . ," In Re Thomas Heath, 36 Law Ed. 358, 359, 144 U. S. 92; "If . . . . the powers conferred are expressly enumerated, this, under the maxim of 'expressio unius est exclusio alterius,' implies the exclusion of others not enumerated." State vs. Missouri Athletic Club, 170 S. W. 904, 909.

(d) ANSWER TO SOME OF THE REASONS GIVEN IN SUPPORT OF THE POWER OF BANKS TO PLEDGE ASSETS TO SECURE PRIVATE DEPOSITS.

(1) There is an essential difference between a deposit and a loan.

The argument most often advanced in favor of the power to pledge is supposed analogy between a loan and a deposit, and Appellant urges this argument in its brief. In a recent law review note[6] the able author thus states and answers the argument:

> "It is now conceded law that a bank has the corporate power to borrow money and to hypothecate its assets to secure the loan. Arguing with this point as a premise, many of the courts sustaining the majority view have used the following syllogism:
>
> (1) A bank may pledge its assets to secure a loan; (2) a deposit is, as a matter of law, a loan; (3) therefore, a bank may pledge its assets to secure a (public) deposit. This has been a favorite argument, and much verbiage has been spent upon it. The fault lies in the minor premise, for a deposit is most clearly not a loan. While it is true that the result of both transactions is the relationship of debtor and creditor, that is the only similarity between the two, and apart from this the two are different to their very roots. The reasoning that a deposit and a loan are the same results from accentuating this sole similiarity between the two. That a debtor-creditor relationship results from both transactions is mere *legis accidens*, and by no means warrants the conclusion that the two are alike for all purposes."

In a Minnesota case, *Farmers and Merchants State Bank of Ogilvie v. Consolidated School District,* 219 N. W. 163,

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6 Bernard F. Cataldo in 79 U. of Pa. L. Rev. 608, on 614 (1931).

65 A. L. R. 1407, (Minn., 1928) the Court refers to an opinion from another state based on the analogy between loans and deposits, and answers the argument thus:

> "The essential premise of that opinion is that, with respect to the power to give security, bank deposits and bank borrowings are alike. That seems to us unsound. Bank deposits and bank borrowings are alike in but the one respect that one result of each is the relation of debtor and creditor. In every other respect the two operations are not only different but in complete antithesis. *Deposits are attracted by the strength of a bank, whereas its borrowings are compelled by weakness or other adverse circumstance.* (The borrowing of money has been said to be 'so much out of the course of ordinary and legitimate banking as to require those making the loan to see to it that the officer or agent acting for the bank had special authority to borrow money.' Western National Bank v. Armstrong, 152 U. S. 346.) Large deposits signify health and large borrowings bank disease. Springing from opposite causes, the two by their existence signify opposite conditions—deposits the normal and borrowings the abnormal. Moreover, the anthithesis holds to the end, for the withdrawal of a deposit is a loss whereas the payment of a loan is a gain. Deposits continued and increased evidence banking success, whereas, borrowings continued and increased portend failure. Save in the relation of debtor and creditor common to both, the two are different in their every incident—not only different but opposed in origin, in purpose, and in effect. *How it comes then that the obvious truth that a bank may pledge collateral for borrowed money can be used to sustain the same power in the case of deposits we cannot understand. The former is clearly necessary, usual and incidental; whereas the latter is neither necessary, usual or incidental, but is positively dangerous.* Therefore, we repeat, we consider it not possessed by any state bank in

Minnesota. It is not an express power and clearly not included among those implied."

So, in a North Dakota case, *Divide County v. Baird*, 212 N. W. 236, 51 A. L. R. 296, (N. D., 1926), the argument is answered thus:

> "The doctrine that there is no difference between a loan and a deposit we cannot accept in all its implications. It is true that in law the two transactions have many characteristics in common; but so have other business deals which, nevertheless, are not identical in all their legal incidents. The striking fact remains, a fact which this court cannot ignore, that a real difference between a deposit and a loan has always been assumed, as a matter of custom, in the banking business itself, and in all legislation dealing with the subject since statehood.
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> "We are warranted in taking judicial notice of the fact that, in the banking business, it has been and still is customary to treat loans and deposits as distinct and essentially dissimilar transactions. Without going into details, this fact is evidenced by methods of bookkeeping and of making reports of the financial condition of the bank, both to private individuals, through the press or otherwise, and to the public examiner.
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> * * * * *
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> "We think the conclusion necessarily follows that there is such a distinction between a deposit and a loan of money that no helpful analogy can be drawn, with respect to the power to pledge paper to secure a deposit, from the fact that the assets of a bank may be pledged to secure a loan."

Of course there is no doubt that all banks, under certain circumstances, can borrow money and give security therefor. But the Courts expressly say that the business of a bank is to lend and not to borrow money, and that

the power to borrow can be exercised only when a bank is embarrassed, or when large sums of money must be raised in sudden contingencies. It is to be noted that the power to borrow is granted solely to protect investments and assets (which constitute the depositors' protection) and not to procure money with which to make new investments. In other words, borrowing is permitted because it is necessary to protect depositors, and only then. But the pledging of assets in order to procure or retain a deposit is an entirely different thing; instead of protecting depositors, it distinctly prejudices them, and it violates the bank's duty of equal, fair and uniform treatment of all depositors.

In this connection, it has sometimes been argued that the mass of depositors cannot complain against a pledge to secure a deposit because the assets withdrawn and pledged are replaced by the deposit. The argument is thus answered:[7]

> "There has also been a suggestion advanced in two or three cases that the private depositor has no complaint against such pledging because the amount received as a deposit is equal to the assets hypothecated. *En bref*, that portion carved out of the bank's assets by a pledge to the depositor is replaced by the deposit. While this answer to the matter is tinged with the semblance of persuasion, it is not satisfactory. In the first place, it is quite manifest that the depositor may well require more security than an amount which will barely cover his deposit. Secondly, the assets are clearly the bank's property, whereas the deposit received is not, notwithstanding the 'legal title' is in the bank, since the depositor

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7 B. F. Cataldo in 79 U. of Pa. L. R. 608, (1931) on 616.

may draw thereon. While the pledge remains static, the amount of the deposit may dwindle, and matters are allowed to remain in *statu quo* by the bank, in the hope that *carus cliens* will soon swell his deposit; and in the meantime the bank has virtually deprived itself of a profitable slice of its property, to the detriment of its private depositors. Further, it must be borne in mind that the validity of the pledge is assailed only *after the bank has become insolvent.* This contention, as well as others advanced in support of the majority rule, oblivious of this fact, seems to be based on the thought that the validity of the transaction is to be determined primarily from looking at the conditions existent either when the pledge was made, or the private customer deposited his money with the bank. Naturally, while the bank is in good condition, there is little fault to find with such a pledge. However, the bank may well pledge its assets after it has received the private customer's deposit; and above all, the very reason why the pledge should be condemned is because of the everpresent contingency that the bank may become insolvent, and because in that event the unsecured depostors are deprived of assets which should go to the payment of their claims. Therefore, when, after the insolvency of the bank, the court is called upon for the first time to pass upon the validity of the pledge, it is futile to look at the transaction as one isolated in time, or to try to determine by segregation into temporal compartments that which should not be so treated."

(2) There is a basis for discriminating between public and private deposits.

Cases may be cited where, even in the absence of statute, banks have been allowed the right to pledge their assets to secure public deposits. There is a real distinction. Originally, at common law, the sovereign had pre-

ference over other creditors of an insolvent bank.[8] The opinion in the above case by the Court of Civil Appeals was reversed by the Supreme Court of Texas,[9] but the Supreme Court recognized the preference accorded the sovereign under the common law.

Some of the Courts sustaining public pledges are influenced by the old doctrine of the prerogative right granting to the state priority in distribution, and the argument has been stated thus:

> "If then, the state is ultimately to have a preference, what difference does it make whether it realizes the enjoyment of this preference by force of its prerogative right of priority after the insolvency of the bank, or by receiving a pledge of the assets from the same bank, and enforcing the same after the failure of the latter? The result to the other depositors is identical." [10]

The public has an interest in having public funds paid. This interest has very generally been recognized as a reason for granting a preference in favor of public funds, sometimes by statutes expressly authorizing such preference, and sometimes by judicial construction permitting it. The reason for the rule in the case of public deposits is absent in the case of private deposits. Custom and the requirements of competition may have rendered it advisable and necessary to give security for public deposits. Quite the contrary is true in the case of private deposits.

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8 State Bank of Commerce v. U. S. F. & G. Co., 28 S. W. (2d) 184.

9 48 S. W. (2d) 974.

10 79 U. of Pa. Law Review, 608 on 619 (1931).

(e) DISCUSSION OF AUTHORITIES.

So far as the decision of the Federal Courts are concerned, the only case directly in point with which we are familiar is *Smith v. Baltimore and Ohio Railroad Company,* 48 Fed. (2d) 861, affirmed by the Circuit Court of Appeals of the Third Circuit, 56 Fed. (2d) 799. That decision fully sustains our contentions in this case. The Court will find the opinion of the Trial Court, in 48 Fed. (2d) 861, very full and complete, with logical answers to all of the contentions made by the Railroad Company.

The case of *Sneeden v. City of Marion,* 64 Fed. (2d) 721, decided April 25, 1933, by the Circuit Court of the Seventh Circuit, while it deals with a public instead of a private deposit, fully sustains our views in this case, and refutes all of the arguments presented by opposing counsel.

In the opinion in the case of *Parks v. Knapp,* 29 Fed. (2d) 547, decided by the Circuit Court of Appeals, Eighth Circuit, November 19, 1928, we find these statements:

> "National banks are authorized to receive deposits. Their express power on that subject stops there. That is one of their principal functions and business. Morse on Banks and Banking (5th Ed.) Vol. 1, Sec. 48, says:
>
> > 'The banking powers are those which are either fundamental parts of the business, or have become so linked with them as to be identified with the exercise of the banking franchises.'
>
> "We are not advised that the transfer of a bank's assets to secure a depositor has become a general custom and thus so linked in practice with its express powers as to be recognized in the banking business as an incidental or implied power. We are inclined to believe with the Kentucky Court of Appeals and the Supreme Courts of Minnesota and North Dakota

that such a practice is not in keeping with sound banking methods, can only result in unfair discrimination and preferential treatment of its depositors, and ought not to be judicially approved. It enables those who are wary, usually because of large deposits, to gain advantage over the great number of small trustful depositors, and thus public confidence in banking institutions is shaken, to the public's detriment."

The decision, however, is based upon another point, and the quoted remarks must be classed as *dicta.*

Appellant relies upon the opinion of the Circuit Court of Appeals of the Fourth Circuit in the case of *Burrowes v. Nimrocks,* 35 Fed. (2d) 152. This case, in effect, upheld a pledge of assets to secure a call loan, rather than a public deposit. The Court spoke of the transaction as follows:

> "It was more nearly analogous to a call loan than to an ordinary deposit."

Appellant also relies upon an opinion by the same Court in the case of *Schumacher v. Eastern Bank and Trust Company,* 52 Fed. (2d) 925. It is true that in that case there is an expression by the learned judge who wrote the opinion to the effect that there is no valid distinction between pledging assets to secure a private deposit, and pledging assets to secure a public deposit. This expression was merely *dicta,* for the Court says:

> "But, without deciding what would be the rule in the case of an ordinary private deposit, we are satisfied that deposits by a bank, such as those involved here, made as loans to, and for the accomodation of, the bank in which they are made, do not come within that category."

We also call the Court's attention to the fact that both of these opinions by the Fourth Circuit had to do with

facts occurring prior to the amendment of June, 1930. Congress had not yet, by passing this amendment, indicated its views that under pre-existing law such pledges were not allowed, nor had Congress, by such amendment impliedly prohibited pledges other than those authorized by the amendment.

The following well considered cases from State Courts fully sustain our contention: *Austin v. Lamar County,* 26 S. W. (2d) 1062; *Foster v. City of Longview,* 26 S. W. (2d) 1059; *Arkansas-Louisiana Highway Association v. Taylor,* 6 S. W. (2d) 533; *Commercial Bank and Trust Company v. Citizens T. & G. Company,* 45 L. R. A, (N. S.) 950, 156 S. W. 160; *Divide County v. Baird,* 212 N. W. 236; *State Bank of Commerce v. Stone,* 184 N. E. 750 (New York, 1933).

B. THE RECEIVER IS NOT ESTOPPED FROM ASSERTING THE INVALIDITY OF THE PLEDGE AND IS ENTITLED TO RETAIN THE BONDS FREE OF THE PLEDGE.

I. Authorities sustaining our contention:

Corpus Juris has this to say with reference to the rule in the Federal Courts in Volume 14A, page 580:

> "According to the view held by the Supreme Court of the United States, and many of the state courts, a contract which is ultra vires in the true sense as being outside of the object of its creation as defined in the law of its organization, is void. Under this view, no action may be maintained upon the contract itself, and the contract cannot be ratified by either party because it could not have been authorized by either; nor can any performance upon either side afford validity to the contract, or be the basis of any right of action upon it."

In *Central Transportaion Company v. Pullman Company,* 139 U. S. 24; 35 Law Ed. 55, 68, 69, the Supreme Court said:

> "A contract of a corporation, which is ultra vires, in the proper sense, that is to say, outside the object of its creation as defined in the law of its organization, and therefore beyond the powers conferred upon it by the Legislature, is not voidable only, but wholly void, and of no legal effect. The object of the contract is, not merely that the corporation ought not to have made it, but that it could not make it. The contract cannot be ratified by either party, because it could not have been authorized by either. No performance on either side can give the lawful contract any validity, or be the foundation of any right or action upon it."

And,

> "A contract ultra vires being unlawful and void, not because it is in itself immoral, but because the corporation, by the law of its creation, is incapable of making it, the courts, while refusing to maintain any action upon the unlawful contract, have always striven to do justice between the parties, so far as could be done consistently with adherence to law, by permitting the property or money, parted with on the faith of the unlawful contract, to be recovered back or compensation to be made for it."

In *De La Vergne Refrigerating Company v. German Savings Institution,* 175 U. S. 40, 59, 44 Law Ed. 65, 72, the Supreme Court said:

> "The doctrine that no recovery can be had upon the contract is based upon the theory that it is for the interest of the public that corporations should not transcend the limits of their charters; that the property of stockholders should not be put to the risk of engagements which they did not undertake; that if the contract be prohibited by Statute, every-

one dealing with the corporation is bound to take notice of the restrictions in its charter, whether such charter be a private act or a general law under which corporations of this class are organized."

In *California National Bank v. Nat Kennedy,* 167 U. S. 362, 367, 371; 42 Law Ed. 198, 200, 201, the Supreme Court said, quoting from *Union and Pacific Railroad v. Chicago, R. I. and P. Railroad,* 163 U. S. 564:

> "A contract made by a corporation beyond the scope of its powers, express or implied, on a proper construction of its charter, cannot be enforced or rendered enforceable by the application of the doctrine of estoppel."

The opinion of the Supreme Court in *First National Bank v. Converse,* 200 U. S. 425, 50 Law Ed. 537, is to the same effect.

In the case of *Thomas v. West Jersey Railroad Company,* 101 U. S. 71, 25 Law Ed. 950, at 953, Mr. Justice Miller said:

> "And in regard to corporations, the rule has been well laid down by Comstock, Ch. J., in *Parish v. Wheeler,* 22 N. Y. 494, that the executed dealings of corporations must be allowed to stand for and against both parties when the plainest rules of good faith require it.
>
> "But what is sought in the case before us is the enforcement of the unexecuted part of this agreement. So far as it has been executed, namely: the four or five years of action under it, the accounts have been adjusted and each party has received what he was entitled to by its terms. There remains unperformed the covenant to arbitrate with regard to the value of the contract. It is the damages provided for in the clause of the contract that are sued for in this action; damages for a material part of the contract never performed; damages for the value of a

contract which was void. It is not a case of a contract fully executed. The very nature of the suit is to recover damages for its non-performance. As to this, it is not an executed contract.

"Not only so, but it is a contract forbidden by public policy, and beyond the power of the defendants to make."

So, in the case at bar, The Texas and Pacific Railway Company seeks "the enforcement of the unexecuted part of this agreement."

In the case of *B. & O. Railroad Company v. Smith, Receiver,* 56 Fed. (2d) 799, the Third Circuit of Appeals, in an opinion rendered March 10, 1932, said:

"The railroad has called on the bank or the receiver for its deposit. That it has the right to have and to that extent the bank is its debtor, but in the meantime the bank has become insolvent and is unable to pay in full. Accordingly the railroad must stand with, and not ahead of, the other depositors. All must share alike. The railroad now stands just where it would have stood had it continued as other depositors did, and not required the bank to do an unlawful act which is null and void. The agreement and deposit of these securities are of no effect, just as though they did not exist. Therefore the railroad must now be accorded the same treatment as other depositors and share pro rata with them. It cannot now take advantage of the illegal agreement and thus accomplish exactly what Congress sought to prevent by withholding power from national banks to pledge their assets to secure private depositors."

The holding of the Circuit Court of Appeals of the Seventh Circuit is to the same effect. *Sneeden v. City of Marion,* 64 Fed. (2d) 721 at 730, decided June 1, 1933.

In the case of *Foster v. City of Longview*, 26 S. W. (2d) 1059, the Commission of Appeals of Texas said:

> "With the illegal contract brushed aside, the City appears in the case merely as a depositor whose rights in the Bank's assets are no higher than those of other depositors."

And, in the case of *Austin v. Lamar County*, 26 S. W. (2d) 1062, it said:

> "The question arises as to the banking commissioner having the right to recover the notes from the possession of the county. If the rights of depositors other than the county were not involved, there might be some doubt in this respect. But there can be no doubt here. The vice which rendered the pledge contract illegal was the unauthorized discrimination undertaken to be effected in favor of the county against other depositors. These depositors will suffer loss as a result of the illegal contract, if the county be permitted to retain the notes. The possession of the notes by the county became injurious to these other depositors when the bank closed. Legal injury to the latter arose at that time. Relief from this injury can be obtained only through the banking commissioner. Plainly, then the banking commissioner, in the discharge of his duty in this respect, is entitled to recover the notes. The fact that a recovery of the notes by the banking commissioner will incidentally inure, to some extent, to the benefit of ordinary creditors whose rights are not infringed by the illegal transaction, cannot preclude such recovery. The county having no equities arising under the illegal contract, there are none to be adjusted."

In *Divide County v. Baird*, 212 N. W. 236, 244, the Supreme Court of North Dakota said:

> "This Court has adopted the view that the receiver of an insolvent bank, in addition to being an officer

of the court, represents the creditors (depositors) as well. We, and the courts generally, have distinctly recognized this dual aspect of the receiver's character. Nor are the interests of the depositors and of the corporation by any means wholly identical. Here a bank has illegally, in violation of positive statutes intended to protect depositors in banks, induced a county to violate another statute, also enacted in execution of the purpose to protect the interests of depositors, and secured a deposit of public funds by delivering a quantity of bills receivable as collateral; the county seeks to foreclose the pledge, with a double taint of illegality upon it, after the bank has become insolvent and is in the hands of a receiver to be wound up for the benefit of its creditors, who had nothing to do with the consummation of the unlawful scheme and were powerless to prevent it. The basis of the rule that the courts will leave the parties to an illegal contract where it finds them is that it will not aid or reward a wrongdoer. Here the depositors are guilty of no wrong; shall they be punished for the misdeeds of the guilty? When the wrong was done, they were powerless to speak or prevent it; now an officer of the court is charged with the duty of protecting their interests. Shall we say to him that there is no remedy whereby the innocent may be protected from the consequences of the unlawful conduct of the others? Section 22 of our Constitution provides that:

> 'The Courts shall be open, and every man for any injury done him . . . . shall have remedy by due process of law . . . . '

"And yet it is said that the court, after finding the injury, can only slap the defunct bank and the delinquent county on the wrist, and say to the depositors:

> 'We must leave you where we find you; we can do nothing, because the transaction was illegal,

and you have not returned something which, not you, but the bank got from the plaintiff.'

"To state the position ought to be sufficient to demonstrate its utterly untenable character. Such a holding would be a confession of judicial impotence to which the court is not prepared to subscribe. It would mean a notice to the people of this state that we are alike powerless to correct the wrongs which have been committed in the past and to prevent their repetition in the future. Once the parties are successful in executing their unlawful purpose, the victims of the legal fraud, although they are also the beneficiaries of the statutes which have been flouted, are helpless, and this court can do no more than convert itself into a debating society where legal theories may be expounded without practical or useful results. A tribunal without power to do justice is not a court of equity, but an academy. If we are powerless to give effect to the plainly expressed purpose of the Legislature to protect depositors, it is a usurpation to assume the name and put on the semblance of a court of equity."

Under the rule applicable to ultra vires contracts and those which are contrary to law, the party who has given up money may have Judgment for the return of the money, but he may not enforce his illegal contract.

In the present situation, the Railroad has a valid claim against the Receiver for the amount of its deposit with the Bank. This claim has been allowed. But the Railroad has no right to enforce a lien on the Liberty Bonds, because such lien in law has never existed.

II. Reply to Appellant's contentions:

Appellant quotes a general statement from *Scott v. Armstrong*, 146 U. S. 507, 36 Law Ed. 1062. We have no fault to find with such statement. The case is, however, not in point.

Appellant next quotes from *Brown v. Schleier*, 118 Fed. 981, 986-87. In that case, the Receiver for a national bank sought a recovery upon the theory that a lease which had been executed by a national bank was void, and that the Receiver would be entitled to recover back the consideration which had been paid in connection with the lease. The Circuit Court of Appeals correctly held that a national bank had a right to lease property upon which to transact its business and to construct a building upon such leased property. This was sufficient to have determined the case. The contention had been made that the bank had expended too much money in the construction of its building upon the leased premises. The Court said:

> "Another fact to be kept in mind is that the case in hand is not one where the bank assumed the exercise of a power which did not belong to it; but it is a case where, in the exercise of a power that was clearly conferred, it misused or abused it by making a greater expenditure for an authorized object than it ought to have made. Besides, the wrongful expenditure was made ten years before the present bill was filed. The building was completed in January, 1891, and the transaction at that time became an executed transaction."

In that case, the entire transaction had been fully completed on both sides many years before the Receiver was appointed. Moreover, while this case was affirmed by the Supreme Court[11] that Court disposed of the ultra vires feature of the case in the following language:

> "And, Appellant concedes 'that only the government may complain of an executed ultra vires conveyance of real estate to a corporation.' "

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11 Brown v. Schleier, 194 U. S. 18-25; 48 Law Ed. 857.

In other words, that Court merely stated counsel's own concession, that where a bank has acquired and paid for real estate before its insolvency, and the entire transaction has been closed on *both sides,* a Receiver could not thereafter set aside the transaction on the ground that the Bank had wrongfully acquired the property. In our case, the transaction has never been completed. The Texas and Pacific Railway Company is now seeking to have the illegal and void contract enforced, and to have the void lien foreclosed. This it cannot do.

Appellant then says:

> "Instead of applying the holding in the Pullman Car case, [12], this Court should apply to the case at bar the rule followed in most jurisdictions that 'an ultra vires transaction when executed by one of the parties may become enforceable by estoppel' (Corpus Juris, Vol. 14a, Sec. 2170, p. 324), which rule, Corpus Juris says, 'some of the lower federal courts,' evidently influenced by the rule of their local jurisdictions, have followed in holding that 'a party to an ultra vires transaction who has enjoyed the benefits thereof is estopped from denying its validity,' (C. J. Vol. 14a, Sec. 2170, pp. 325, 326)."

Appellant does not complete its quotation from Corpus Juris, Vol. 14a, page 325 (324). We give the full quotation:

> "Some of the lower Federal Courts have not been consistent in following the rule of the Supreme Court of the United States, and, evidently influenced by the rule of their local jurisdictions, have held that a party to an ultra vires transaction who has enjoyed the benefits thereof, is estopped from denying its validity."

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12 Central Transportation Company v. Pullman Palace Car Company, 139 U. S. 24, 48, 35 Law Ed. 55.

We also quote from Corpus Juris, Vol. 14a, page 319, Section 2169:

> "The doctrine of the Supreme Court of the United States, together with the English Courts, and some of the State Courts, is that no performance on either side can validate an ultra vires transaction or authorize an action to be maintained directly upon it."

Substantially the same statement is found in Corpus Juris, Vol. 14a, page 582, Section 2529.

In Corpus Juris, Vol. 14a, page 326, note (a), it is said:

> "One of the Federal Courts has taken the view that the rule followed by the Supreme Court applies only to quasi public corporations, and not to private corporations, *Bowman v. Foster, Etc., Hardware Company,* 94 Fed. 592, 597 (where it is said: 'I am aware that quasi public corporations—as, for instance, railroad corporations—which owe important duties to the public, are governed by a different rule. They will not be allowed to do any ultra vires act which, in effect, disqualifies them from discharging their duties to the public; and, if they do, they are not estopped to invoke the doctrines of ultra vires.')."

The business of banking is charged with a public interest. It is in the interest of the depositors and general creditors that a bank is prevented from pledging its assets to secure the payment of deposits except when specially authorized by Statute. This same public interest demands that the illegal lien be declared unenforceable.

A full reading of the cases heretofore cited on the question of estoppel will make the existence of this public interest clearly apparent.

Appellant cites the case of *Eastern Building and Loan*

Association v. Williamson, 189 U. S. 122, 47 Law Ed. 735. In the opening paragraph in that case, Mr. Justice Brewer said:

> "The Federal question presented arises on the contention that the South Carolina Courts did not give 'full faith and credit . . . .to the public acts, records and judicial proceedings' of the State of New York. . . ."

The learned Justice then quotes, from the decision of the Court of Appeals of New York, and says:

> "We deem it unnecessary to add any observations of our own to these satisfactory declarations of the *law of New York.*"

Appellant also relies upon the case of *State Bank of Commerce v. Stone,* 184 N. E. 750 (N. Y. 1933). Here again, the Court merely states the New York doctrine, which is entirely different from the doctrine approved by this Court.

Corpus Juris, in Vol. 14a, at page 319, Section 2169, says:

> "The doctrine of the supreme court of the United States together with the English courts and some of the state courts is that no performance upon either side can validate an ultra vires transaction or authorize an action to be maintained directly upon it. However, the great weight of authority in the State courts is to the effect that a transaction which is merely ultra vires and not malum in se or malum prohibitum although it may be made by the state a basis for the forfeiture of the corporate charter or the dissolution of the corporation, is, if performed by one party, not void as between the parties to all intents and purposes, and that an action may be brought directly upon the transaction and relief had according to its terms."

Then follows a list of cases showing that New York is one of the states which does not follow the ruling of the Supreme Court with reference to the enforcement of ultra vires tracts.

Appellant also cites *Shornick v. Butler,* 185 N. E. 111. This is an Indiana case. In that state, as shown by the note in Corpus Juris, the New York rule is followed, not the rule of this Court.

Analagous to the question here presented would be a case such as we now state. In Texas, the head of a family may not give a valid mortgage upon his homestead except for purchase money and improvements. Suppose a case where, in violation of such law, a married man gives his note for $5000.00, secured by a mortgage on his home, and obtains from a banker the sum of $5000.00 on the faith of such note and mortgage. Concede that the banker, while knowing that the property is a homestead, believes that the mortgage is valid. Would anyone contend that the banker could not only sue and recover Judgment for the return of the money, but could also foreclose a lien on the homestead? The Court would certainly hold that a valid lien never existed, and could not be foreclosed.

We must remember that the Liberty Bonds here involved were never the property of The Texas and Pacific Railway Company.

They were at all times the property of the Bank.

The Bank did not receive these bonds by reason of the ultra vires contract.

The Receiver is unquestionably the owner of the bonds now.

The Texas and Pacific Railway Company is seeking to foreclose a lien upon the bonds. The lien is void.

The Court refused to foreclose the void lien, and declared the lien to be void.

If the Bank were solvent and if The Texas and Pacific Railway Company were suing the Bank for the amount of the deposit and asking Judgment for foreclosure of a lien on the Liberty Bonds, the Court would enter Judgment for the amount of the deposit, but would deny the prayer for a foreclosure of a lien on the Bonds, because no lien in law ever existed.

So, in this case, Appellant has Judgment for the amount of its deposit, but it is denied its prayer for a foreclosure of lien.

C. NO BASIS EXISTS FOR GRANTING THE TEXAS AND PACIFIC RAILWAY COMPANY A PREFERRED CLAIM AGAINST THE RECEIVER FOR THE AMOUNT OF ITS DEPOSIT BALANCE.

Argument

This Court is, of course, familiar with the proof that must be made in order to obtain a preference.

It must be shown that the deposit was made with the understanding that the funds deposited should be held in trust and not used by the bank in its business as its own funds. Here, the evidence clearly indicates that the parties intended that the deposited funds should be used by the bank in its business, and that a debtor and creditor relation should exist.

Since the parties intended that the deposited funds should be used by the bank as its funds, no presumption

arose to the effect that the deposited funds would be kept in the possession of the bank.

In the second place, in order to establish a preference, is must be shown that new money, in cash, came into the possession of the bank, as a result of the particular transaction, and that such money remained in the possession of the bank until insolvency, and was then delivered over to the Receiver.

In this case, there is no proof to show that after January 29, 1931, new money, in cash, came into the bank from The Texas and Pacific Railway Company.

No proof was offered to show whether, after January 29, 1931, the bank had any cash in its vaults.

No showing was made as to the amount of cash on hand when the bank became insolvent.

It does not appear how much, if any, cash passed into the possession of the Receiver. There is no proof that the assets delivered to the Receiver were augmented by any deposits made by The Texas and Pacific Railway Company.

No fund or property in the hands of the Receiver is shown to be impressed with a trust in favor of The Texas and Pacific Railway Company.

There was no basis, either in the pleadings of the Railroad Company or in the evidence introduced, to justify the allowance of a preference.

A few of the authorities which sustain the propositions above stated are: *Schuyler v. Littlefield,* 232 U. S. 707; *Blakely v. Brinson,* 286 U. S. 254; *Keyes v. Paducah and*

Illinois R. R. Co. 61 Fed. (2d) 611; *Empire State Surety Co. v. Carroll County*, 194 Fed. 593, 604; *Frelingheusen v. Nugent*, 36 Fed. 229, 239; *American Can Company v. Williams*, 178 Fed. 420, 422, 423; *Board of Commissioners v. Strawn*, 157 Fed. 49, 54; *Larabee Flour Mills v. First National Bank*, 13 Fed. (2d) 330, 331; *Dudley v. Richards*, 18 Fed. (2d) 876, 878; and *In Re Brown*, 193 Fed. 24, 29.

Respectfully submitted,

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APPENDIX

December 13, 1929.

Mr. Lewis E. Smith,
Grand Secretary,
Grand Lodge A. F. & A. M. of Nebraska,
401 Masonic Temple,
Omaha, Nebraska.

Dear sir:

Your letter of December 7 is received, stating that the Grand Lodge A. F. & A. M. of Nebraska has for several years carried a balance with a national bank, that this deposit has been secured by the bank depositing with the proper officers of the Grand Lodge Liberty bonds and Treasury certificates, and requesting to be advised whether it is legal for a national bank to secure a deposit of this sort in this manner.

There is no provision in the national banking laws expressly prohibiting the securing of deposits, but inasmuch as Congress has recognized the fact that the deposits of Federal moneys should be secured (Section 5153, U. S. R. S.), this office has always held that a national bank may pledge its assets to secure public deposits made subsequent to the pledge thereof. However, it is not believed that a national bank may pledge any of its assets to secure private deposits.

Respectfully,

(Signed) F. G. AWALT,
Deputy Comptroller.

APPENDIX

January 30, 1931.

President,
First National Bank,
Hornell, New York,

Dear sir:

Your letter of January 26 is received, stating that you have recently pledged certain of your securities for the purpose of securing a deposit placed with your bank by one of your correspondent banks; that Examiner O'Connor has informed you that according to Federal legislation passed sometime in the early part of 1930 national banks are prohibited from pledging any of their assets to secure deposits other than New York State deposits and postal savings, and requesting to be advised in regard thereto, and to be furnished a specific citation of the section of law covering this point.

The Act of June 25, 1930, amending Section 5153, U. S. R. S., expressly provides that:

> "Any association may, upon the deposit with it of public money of a state of any political subdivision thereof, give security for the safe keeping and prompt payment of the money so deposited, of the same kind as is authorized by the law of the State in which such association is located in the case of other banking institutions in the state."

The position of this office is that a national bank may not pledge any of its assets to secure individual deposits.

Respectfully,
(Signed) F. G. AWALT,
Deputy Comptroller.